

February 17, 2005

Ms. Marlene H. Dortch, Secretary  
Federal Communications Commission  
445 12<sup>th</sup> Street SW  
Washington, DC 20664

Re: WC Dkt. No. 03-266 (Ex Parte Filing)

Dear Ms. Dortch:

Our companies, each of which makes products used in providing numerous types of telecom services, write to apprise the Commission of the negative impact on telecom investment that the grant of Level 3's petition likely would produce. That petition asks the Commission to let VoIP service providers pay local exchange carriers ("LECs") the reciprocal compensation rate rather than the higher interstate access charge rate, as existing FCC regulations require, when a long distance call they transport is either originated or terminated by a LEC.

The Commission should not grant the Level 3 petition because doing so would hurt telecom investment. Section 10 of the Communications Act authorizes the FCC to forbear from applying an existing regulation *only* if the petitioner proves, among other things, that forbearance would be consistent with the public interest. Exempting companies that provide VoIP service that is originated or terminated by LECs from the requirement to pay access charges would not be consistent with the public interest since it would have a negative impact on telecom infrastructure investment.<sup>1</sup> This is so because LECs then might be unable to recover their operating costs given that they would be denied substantial revenues to which the access charge regulations entitle them. If LECs reduced their infrastructure investment due to reduced revenues, VoIP and other broadband access technologies (such as DSL and fiber) almost certainly would be negatively affected since most infrastructure spending budgeted by LECs for the foreseeable future is for the deployment of new broadband technologies.

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<sup>1</sup> Section 706 of the Communications Act authorizes the Commission to consider the impact of regulatory proposals on infrastructure investment, authority to which FCC Chairman Powell has attached extraordinary importance:

"We need [telecom] service providers buying switches and other equipment from . . . [telecom manufacturers since these] companies are innovators, the R&D arms that have kept . . . [U.S. telecom network[s] at the cutting edge. . . . They must survive for our future."

Chairman Michael Powell speech at the Goldman Sachs Communicopia XI Conference, New York, NY, Oct. 2, 2002.

Although Level 3 and its allies seek to create the impression that the negative effect on infrastructure investment would be minor,<sup>2</sup> this impression does not appear to be accurate since the grant of Level 3's petition would deny LECs a substantial amount of money to which they are entitled under the FCC's access charge rules. The revenue to which LECs would be denied is substantial since the number of minutes of VoIP calls began growing astronomically in the last half of 2004 and is projected to grow even more rapidly this year and faster still in 2006. For example, In-Stat/MDR has reported that while about 12 percent of all U.S. businesses were using VoIP when 2005 began, nearly triple that number -- 34 percent of U.S. businesses -- will be using VoIP by the end of 2005.<sup>3</sup> Even more breathtaking growth is expected this year and next among residential customers since the country's largest cable TV operators began marketing VoIP on a massive scale for the first time only seven or eight months ago. For example, Time Warner had just 10,000 residential VoIP subscribers at the beginning of 2004, was providing VoIP to more than 200,000 customers as 2005 began, is now adding more than 11,000 additional residential customers per week, and expects even larger weekly incremental growth as 2005 progresses.<sup>4</sup> However, even making the conservative assumption that Time Warner will add just 11,000 additional residential subscribers per week throughout 2005 (rather than more than 11,000 per week as it projects), Time Warner *alone* will have nearly 775,000 residential VoIP subscribers by the end of this year. Similarly, Comcast, which did not provide telephone service using VoIP technology last year, announced last month that it will be aggressively marketing VoIP to 15 million Comcast households by the end of 2005.<sup>5</sup>

Companies whose business is focused almost exclusively on providing VoIP service also began increasing their subscribership at breakneck speed beginning about mid-2004. For example, 8x8, which began providing VoIP commercially only last August,<sup>6</sup> served 26,000 customer lines two months later, and at the end of 2004 registered 40,000 lines of service.<sup>7</sup> Net2Phone, which provides VoIP on a contract basis to small cable operators, likewise has grown rapidly within the last six months. It began its VoIP business by providing service to subscribers of Liberty Cablevision of Puerto Rico in early 2004.

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<sup>2</sup> See, e.g., Level 3 Petition at 49-50; Broadwing Comments at 5

<sup>3</sup> [www.itfacts.biz/index.php?id=P2191](http://www.itfacts.biz/index.php?id=P2191).

<sup>4</sup> Presentation by Wayne Pace, Exec. VP and CFO of Time Warner Inc. to 15th Annual Global Entertainment, Media & Telecom Conference, Jan. 9, 2005, available for video replay at [www.veracast.com/webcasts/sbcitigroup/emt-21201597.cfm](http://www.veracast.com/webcasts/sbcitigroup/emt-21201597.cfm).

<sup>5</sup> Presentation by Comcast CEO Brian Roberts to 15th Annual Global Entertainment, Media & Telecom Conference, Jan. 10, 2005, available for video replay at [www.veracast.com/webcasts/sbcitigroup/emt-2005/76107549.cfm](http://www.veracast.com/webcasts/sbcitigroup/emt-2005/76107549.cfm).

<sup>6</sup> See 8x8 2004 Annual Meeting of Shareholders Presentation, Aug. 2004.

<sup>7</sup> 8x8 press release dated Jan. 27, 2005, available for viewing at [www.packet8.net/](http://www.packet8.net/)



By October 13, more than 7,000 Liberty subscribers had signed up for the Net2Phone offering.<sup>8</sup> And in November and December, Net2Phone signed agreements with Bresnan Communications and Millennium Digital Media, respectively, to market the Net2Phone offering to more than 500,000 additional cable subscribers.<sup>9</sup> Covad likewise is adding VoIP customers rapidly. Although it did not start providing VoIP until last summer, by December 31 it was providing VoIP service to 20,500 subscriber stations.<sup>10</sup>

Because of the extraordinarily rapid growth in VoIP subscribership that began in the middle of 2004, it appears that granting Level 3's request to exempt VoIP service providers from the requirement to pay access charges could reduce LEC revenue by several hundred million dollars in 2005, with 2006 losses probably at least triple the 2005 losses (and perhaps four or five times higher than 2005 losses). Granting Level 3's request could have this result since Level 3 states that VoIP providers then would pay LECs only about 0.07 cents per minute in reciprocal compensation charges on average when they use LEC networks to originate or terminate a VoIP call rather than the average of 0.66 cents per minute they must pay under the FCC's access charge rules.<sup>11</sup> While other VoIP providers do not publish their customer usage data, Vonage states on its web site that its existing VoIP customers now make and receive more than 40 million calls each month.<sup>12</sup> Even making the conservative assumption that the average VoIP call lasts just seven minutes and the equally conservative assumption that Vonage's customer base will grow by just 100 percent during 2005 (rather than the 200-300 percent that appears more probable), payments to LECs during 2005 by Vonage *alone* would be nearly \$30 million less under reciprocal compensation than if the payments were calculated under the FCC's access charge rules as existing policy requires.<sup>13</sup> And since Vonage is just one of *many* companies

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<sup>8</sup> Net2Phone 2004 Annual Report at 7, filed Oct. 14, 2004, available at <http://web.net2phone.com/about/investor/2004AR.pdf>.

<sup>9</sup> See Net2 Phone press releases dated Nov. 15, 2004 and Dec. 6, 2004, available at <http://web.net2phone.com/about/>

<sup>10</sup> Covad news release dated Feb. 1, 2005, available at <http://www.covad.com/companyinfo/investorrelations/index.shtml>

<sup>11</sup> Level 3 Petition at 21 ("FCC statistics show that interstate switched access rates average \$0.0066 per access minute (excluding NECA carriers)"; QSI Report, *infra* note 14 at 4 and 23 n.45 (noting that the reciprocal compensation rate is \$0.0007 per minute in situations where the FCC-prescribed reciprocal compensation rate applies).

<sup>12</sup> [www.vonage.com/corporate/aboutus\\_fastfacts.php](http://www.vonage.com/corporate/aboutus_fastfacts.php).

<sup>13</sup> 40 million calls per month x 150% increase in customers ( the average daily customer total increases by 150% when a doubling of customers is averaged over the full year) x 7 minutes per call x 12 months = 5.04 billion minutes for the year. Since LECs would receive about 0.59 cents less for each minute of usage under the reciprocal compensation regime that Level 3 proposes than under the access charge rules, the one year compensation loss from Vonage alone would be nearly \$30 million (i.e., 5.04 billion minutes x 0.59 cents per minute = \$29.7 million).



using VoIP technology to provide long distance phone service, it is likely that the LECs' total revenue losses in 2005 actually would be substantially more than \$150 million if Level 3's petition were granted. Moreover, because VoIP subscribership is expected to grow even faster in 2006 than this year, losses of more than \$150 million in 2005 are likely to triple or quadruple (or worse) in 2006.

Late last month, QSI told the Commission that it thought LECs might lose just \$74 million in 2005 and \$111 million in 2006 if Level 3's petition were granted,<sup>14</sup> but QSI admits that its projections are based on a one-page report by TIA that assumed far *slower* growth in VoIP than it now appears is likely to occur, in part because the TIA report was compiled almost one year ago, several months before the residential VoIP growth rate began to explode.<sup>15</sup> For example, TIA's single page report had projected that Cablevision's VoIP subscribership might be 159,000 by the end of 2004;<sup>16</sup> in fact, Cablevision reported on December 7, 2004 that it had more than 250,000 VoIP subscribers as of that day and that it was then adding an average of 1,000 new customers each day.<sup>17</sup> As a result, rather than having just 159,000 subscribers at the end of 2004, it is far more likely that Cablevision's VoIP subscribership at the end of 2004 was about 270,000<sup>18</sup> – a full 70 percent more than TIA had assumed when TIA prepared the skimpy report upon which QSI relies about nine months earlier. Similarly, Vonage and Time Warner had just 130,000 and 17,000 VoIP subscribers, respectively, when the TIA report was written, but Vonage ended the year with more than 400,000 subscribers, and Time Warner ended the year with 200,000 subscribers, an increase of 200 percent and 1,100 percent, respectively. Because of the dramatic growth in VoIP subscribership beginning about eight months ago, it appears that TIA's early 2004 assumption that VoIP subscribership would grow just 52 percent in 2005 and 42 percent in 2006<sup>19</sup> may have underestimated VoIP growth by at least 100 percent for each year, and probably substantially more than 100 percent.

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<sup>14</sup> See "IP-Enabled Voice Services; Impact of Applying Switched Access Charges to IP-PSTN Voice Services" at 4, filed Jan. 27, 2005 ("QSI Report").

<sup>15</sup> See QSI Report at 19 n. 31.

<sup>16</sup> The TIA Report states that Cablevision had 29,000 VoIP customers at the end of 2003 and was projected to add about 2,500 additional customers per week during 2004, which had it occurred would have meant 159,000 VoIP customers by the end of the year.

<sup>17</sup> See Cablevision news release of Dec. 7, 2004, available at [www.cablevision.com/index.jhtml?id=2004\\_12\\_07](http://www.cablevision.com/index.jhtml?id=2004_12_07).

<sup>18</sup> 250,000 customers as of December 7 + 1,000 additional customers for each of the 24 days between December 8 and December 31 = 274,000 customers.

<sup>19</sup> The TIA Report projected that business and residential VoIP lines combined could increase from 6.5 million in 2004 to 9.9 million in 2005 (a 52% increase) and from 9.9 million in 2005 to 14.4 million in 2006 (a 42% increase).



Moreover, while QSI implies that universal local telephone service might not be jeopardized if LECs were to lose an average of several hundred million dollars per year over the next few years due to the loss of access charge revenue, QSI does not dispute that the loss of that much money each year is likely to cause LECs to decrease investment in infrastructure. Nor would there be credibility in any claim that infrastructure investment would be unaffected by the loss of several hundred million dollars in intercarrier compensation revenue each year since any net reduction in intercarrier compensation revenue would come off the LECs' bottom line and since experience proves that infrastructure investment is among the first casualties when LEC profits decline.

Further, although Level 3 suggests that LECs might be able to replace their lost intercarrier compensation revenue by obtaining the FCC's approval to raise other rates and, if that were unsuccessful, by suing the FCC for unconstitutional confiscation of LEC property in violation of the Fifth Amendment,<sup>20</sup> this approach, even if ultimately successful, almost certainly would result in several years of reduced infrastructure investment. This is because LECs would not be reimbursed for reduced intercarrier compensation until after winning that litigation, and experience shows that the litigation almost certainly would last at least three years, and probably more.

The claim that the reduction in LEC investment in broadband technologies if the Level 3 petition were granted could be offset by increased investment by VoIP providers<sup>21</sup> is misleading even assuming it is technically true. While VoIP providers might have more money to invest if FCC rules requiring them to pay access charges were not applied as Level 3 requests, a large portion of any increased spending necessarily would be used to develop computer systems that distinguish VoIP calls from other long distance calls. Such systems would be needed in order to ensure that LECs charge reciprocal compensation rates when originating or terminating VoIP calls while continuing to charge access charges when originating or terminating other long distance calls. The development of these systems would be a daunting and expensive task.<sup>22</sup> Unfortunately, moreover, this new investment would do *nothing* to improve VoIP service itself but instead would be necessary merely to accommodate the new regulatory regime that the Level 3 petition asks the Commission to implement.

Rather than waive the requirement that VoIP service providers pay access charges without providing LECs with a mechanism to recover their costs in other ways as Level 3 proposes, the FCC instead should reform intercarrier compensation regulations for *all* services at the same time. It can do this by completing action in its nearly four-year-old Intercarrier Compensation proceeding, a rulemaking that was established precisely for that

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<sup>20</sup> Level 3 Petition at 47.

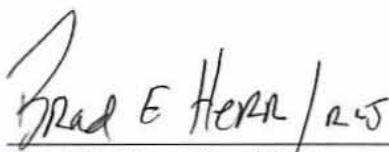
<sup>21</sup> *Id.* at 42.

<sup>22</sup> See, e.g., Memo. of Feb. 4, 2005 from AMA Technical Support Group, filed in this docket on Feb. 10, 2005 by BellSouth.

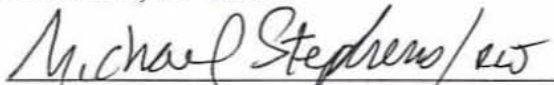
purpose.<sup>23</sup> Just last week, the agency adopted a new order in that proceeding inviting comment on several proposals to revamp *all* intercarrier compensation rules.<sup>24</sup> Interested parties will be able to file comments late this winter, and several of the FCC's Commissioners have stated publicly that they would like to take final action later this year based on those upcoming comments in order to provide a comprehensive and balanced solution to the entire range of intercarrier compensation issues.

In view of the foregoing, the Commission should deny Level 3's petition.

Respectfully submitted,

/RJS

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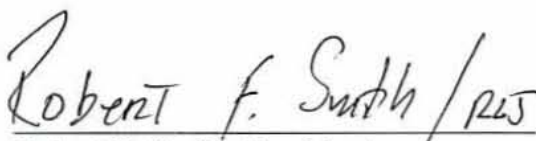
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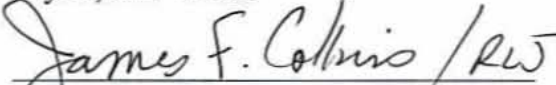
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<sup>23</sup> Notice of Proposed Rulemaking in CC Dkt. No. 01-92, rel. April 27, 2001.

<sup>24</sup> See FCC Press Release dated Feb. 10, 2005 announcing the agency's decision earlier that day to issue a new Notice of Proposed Rulemaking in its Intercarrier Compensation rulemaking, CC Dkt. No. 01-92.



Ms. Marlene Dortch

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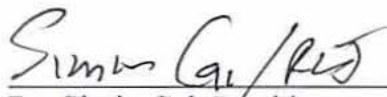
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